

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Brulte Analyst: Kimberly Pantoja Bill Number: SB 1165
Related Bills: See Legislative History Telephone: 845-4786 Introduced Date: 02/23/01
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Research Expenses Credit/20% of Qualified Expenses

SUMMARY

This bill would increase the credit for qualified research expenses from 15% to 20%.

PURPOSE OF THE BILL

According to the author's staff the intent of the bill is to increase the percentage of the state credit for qualified research expenses to be in conformity with the federal percentage for qualified research expenses.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective upon enactment. The increased percentage for the credit would be operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are provided to address the department's technical concern.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law allows taxpayers a research credit that is combined with several other credits to form the general business credit. The research credit is designed to encourage companies to increase their research and development activities.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

04/02/01

To qualify for the credit, research expenses must qualify as an expense or be subject to amortization, be conducted in the U.S., and be paid by the taxpayer. The research must be experimental or laboratory research and pass a three-part test as follows:

1. Research must be undertaken to discover information that is technological in nature. The research must rely on the principles of physical, biological, engineering, or computer sciences.
2. Substantially all of the research activities must involve experimentation relating to quality or to a new or improved function or performance.
3. The application of the research must be intended for developing a new business component. This is a product, process, technique, formula, or invention to be sold, leased or licensed, or used by the taxpayer in a trade or business.

Ineligible expenses include seasonal design factors; efficiency surveys; management studies; market research; routine data control; routine quality control testing or inspection; expenses incurred after production; development of any plant, process, machinery, or technique for the commercial production of a business component unless the process is technologically new or improved.

California conforms to the federal credit with the following modifications:

- The state credit is not combined with other business credits.
- Research must be conducted in California.
- The credit percentage for qualified research in California is 15% versus the 20% federal credit.
- The credit percentage for basic research in California, limited to corporations, is 24% versus the 20% federal credit.
- The percentages for the alternative incremental research portion of the credit vary from the federal credit.

The California research credit is allowed for taxable years beginning on or after January 1, 1987, and is permanent.

THIS BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would increase the state credit for qualified research expenses from 15% to 20%.

IMPLEMENTATION CONSIDERATIONS

Implementation of this bill would occur during the department's normal annual system update.

TECHNICAL CONSIDERATIONS

Amendments are provided to correct the references from "income" year to "taxable" year.

LEGISLATIVE HISTORY

AB 465 Nakano (Stats. 2000, Ch. 103) increased the state alternative incremental research expense credit to 85% of the prior federal amount, instead of the existing 80%.

AB 1953 (Cunneen, 1999/2000), AB 2592 (Campbell, 1999/2000), SB 1495 (Brulte, 1999/2000), and SB 2200 (Dunn, 1999/2000) would have increased the qualified research expense credit percentage and would have decreased the minimum threshold for computing the credit. AB 1953 was held in Assembly Appropriations Committee, AB 2592 was held in the Assembly Revenue and Taxation Committee, and SB 1495 and SB 2200 were held in the Senate Revenue and Taxation Committee.

SB 705 Sher (Stats. 1999, Ch. 77) increased the state credit for qualified research expenses from 11% to 12%.

AB 68 (Cunneen, 1999/2000) would have increased the qualified research expense credit percentage and would have decreased the minimum threshold. AB 68 failed to pass out of the Assembly.

OTHER STATES' INFORMATION

The laws of the following states were reviewed because their tax laws are similar to California's income tax laws.

Florida excludes from the payroll factor for apportionment purposes compensation attributed to Florida that is dedicated exclusively to research and development activities performed pursuant to sponsored research contracts with a state university or certain nonpublic universities. This exclusion is for corporate income tax purposes only as Florida does not have a personal income tax.

Illinois corporate and individual taxpayers may claim an income tax credit for qualified expenditures that are used for increasing research activities in Illinois. The credit equals 6 1/2% of the qualifying expenditures.

Massachusetts corporate taxpayers, but not individuals, may claim an income tax credit for qualified expenditures that are used for increasing research activities in Massachusetts. The credit is 15% of the basic research expenses and 10% of qualified research expenses conducted in Massachusetts.

Michigan, Minnesota and New York do not allow a research credit.

FISCAL IMPACT

This bill is not expected to significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

This bill would result in revenue losses as follows:

Estimated Revenue Impact of SB 1165 As Introduced February 23, 2001 \$ Millions			
2001-02	2002-03	2003-04	2004-05
-\$20	-\$34	-\$44	-\$48

This estimate does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Estimate Discussion

The research credits generated under current and proposed laws are simulated for each corporation in a sample of the 50 corporations with the largest research and development expenses. These simulations take into account specific micro-economic data for each corporation such as gross receipts, wage, property and sales factors, net income, historical research expenditures, and detailed tax and financial data. The results of the simulations are weighted statistically to the population level. The revenue losses are estimated as the differences between the taxes simulated under current and proposed laws.

The Department of Finance forecast of corporate profits is used to extrapolate the estimates to future years.

The revenue impact for the PITL is assumed to be equal to 4.8% of the B&CTL impact and is added to the corporate impact.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1165
As Introduced February 23, 2001

AMENDMENT 1

On page 4, line 16, strike "income" and insert:

taxable

AMENDMENT 2

On page 4, line 20, strike "income" and insert:

taxable

AMENDMENT 3

On page 4, line 26, strike "income" and insert:

taxable

AMENDMENT 4

On page 4, line 33, strike "income" and insert:

taxable

AMENDMENT 5

On page 4, line 39, strike "income" and insert:

taxable

AMENDMENT 6

On page 6, line 33, strike "income" and insert:

taxable

AMENDMENT 7

On page 6, line 38, strike "income" and insert:

taxable

AMENDMENT 8

On page 7, line 10, strike "income" and insert:

taxable

AMENDMENT 9

On page 7, line 22, strike "income" and insert:

taxable

AMENDMENT 10

On page 7, line 23, strike "income" and insert:

taxable

AMENDMENT 11

On page 7, line 24, strike "income" and insert:

taxable

AMENDMENT 12

On page 7, line 39, strike "income" and insert:

taxable

AMENDMENT 13

On page 8, line 1, strike "income" and insert:

taxable

AMENDMENT 14

On page 8, line 4, strike "income" and insert:

taxable